Statement

of the

Property Casualty Insurers Association of America

to the

House Financial Services Capital Markets, Insurance and
Government Sponsored Enterprises Subcommittee

March 31, 2004

The Property Casualty Insurers Association of America (PCI) appreciates the opportunity to present its views on insurance regulatory reform. PCI, the nation's premier property/casualty insurance trade association, was formed in January 2004 through the merger of the National Association of Independent Insurers (NAII) and the Alliance of American Insurers (Alliance), both of which have long histories of association with the subcommittee. The mission of PCI is to foster a competitive insurance marketplace for the benefit of insurers and consumers and to provide a responsible and effective voice on public policy questions affecting insurance products and service.

PCI's members write $154 billion in annual premiums, or 38 percent of the nation's property/casualty insurance. Member companies range in size from billion-dollar national companies to multi-line regional groups to single-state and niche/specialty writers. They include mutuals, stock companies, reciprocals, surplus line carriers and risk retention groups. PCI represents the broadest cross-section of insurers of any national trade association.

PCI members transact most types of property/casualty insurance business, using every type of distribution system. Our members are domiciled in 49 of the 50 states, write coverage in all states and the District of Columbia, and have facilities, employees and policyholders spanning the country. This diversity in membership provides PCI with a unique perspective on insurance regulation.

While PCI members serve a wide variety of personal and business insurance consumers and market their products in many different ways, our companies share the same common vision that competition and market-oriented regulation are in the best interest of the industry and the customers they serve. As reflected in our mission statement, PCI's primary goal in pursuing regulatory modernization is to promote competitive markets and ensure reasonable, efficient and effective regulation.

PCI member companies strive to provide the highest quality products and services to the nation's insurance consumers. Consumers deserve a marketplace that reflects their needs and lifestyles, adapts to changes throughout the years and affords the greatest possible range of choices, while protecting policyholders against insurer insolvency and fraud. PCI member companies support a regulatory environment that allows insurers to offer varied policy choices at a competitive rate. Insurers must also have the ability to adjust policy terms, pricing structures, delivery channels and customer service methods to meet consumer demands and expectations.

PCI members agree with the large majority of insurers, agents, regulators, state legislators and members of Congress that the current insurance regulatory system must improve. Meaningful reforms, which reflect the way business is conducted and are adaptable to the changing business environment, must be adopted. Current regulatory systems frequently cause delays in new product offerings for consumers and impose needless, and costly, rate approval processes. In some states, the company and agent licensing processes are also lengthy and cumbersome. Conversely, in other states, the market withdrawal process is bureaucratic and punitive in nature. Financial and market conduct examinations are often disjointed and inefficient, and suffer from a lack of coordination. These areas of state regulation must be improved and simplified, and greater uniformity must be achieved. Subcommittee Chairman Richard Baker (R-La.) has proposed a series of federal initiatives designed to address these crucial issues.

PCI commends Chairman Baker for his dedication to improving insurance regulation. The subcommittee has conducted more than a dozen hearings and roundtables examining the regulatory environment and determining areas for reform. Throughout the process, the overriding theme of testimony from a wide array of witnesses is the substantial benefit to consumers of competitive insurance markets.

NAII and the Alliance, along with our member companies, were appreciative of the opportunity to participate in the subcommittee's examination and PCI is pleased to continue to offer its views here today. Rather than address specific components of Chairman Baker's outline, PCI is pleased to offer comments on the scope and direction of the chairman's proposal and the association's general policy position on regulatory reform issues.

PCI recognizes Chairman Baker's goal of strengthening and improving the state regulatory system. First and foremost, PCI believes that the greatest chance to achieve this goal, both politically and functionally, is a narrowly targeted package designed to address the core problems of the current regulatory system – namely antiquated price controls that impose barriers to market-based pricing systems. While other areas of reform are important, the single most significant element overshadowing all other reform proposals is the goal of insuring a truly competitive marketplace with open rate competition. On behalf of our members and policyholders, PCI urges the subcommittee to place the highest priority on competitive market reforms and focus its legislative effort in this direction.

In addition, PCI urges the subcommittee to reaffirm, as Congress did in the Gramm-Leach-Bliley Act, the doctrine of state regulation of insurance embodied in the McCarran-Ferguson Act as part of any reform measure.

Competitive Marketplaces

A marketplace in which competition is the primary regulator of insurance rates best serves consumers, regulators and insurers. Competitive insurance markets afford consumers the greatest choice among service providers, pricing options and insurance products. PCI fully agrees with full committee Chairman Mike Oxley's observation that "without change, consumers face a world with fewer options, less competition, and less available coverage."

Unfortunately, many states still attempt to control prices by requiring insurance companies to get "prior approval" from insurance regulators before adjusting their rates up or down. This strict regulatory method remains in place because of the political pressure to give the appearance of control over, or reduction of, insurance prices.

However, experience shows that prior approval systems make rates more susceptible to political manipulation and that consumers in states with prior approval regulation ultimately end up with fewer insurance companies to choose from and may pay more for their policies.

Political manipulation of rates can take various forms including outright disapproval of individual company rate filings. Regulators may also disapprove use of particular classification plans, rate factors and even discounts. In some states there are regulatory limits on the differences that can be charged in one territory versus another. This can distort cost-based pricing and lead to subsidies. When regulators prevent insurers from charging policyholders premiums based on rating criteria determined by the insurers, regulators interfere with market freedom. All this political manipulation stifles innovation, leads to higher residual market populations, discourages competition and ultimately hurts consumers.

Nor are laws that provide for file-and-use or use-and-file necessarily a panacea. Often, insurers are unable to use a filed rate for fear that the state might disapprove the rate sometime in the future. Worse, an insurer relying on a filing without the approval from a state might be required to disgorge the difference should the new rate later be disapproved. Thus, when PCI speaks of “prior approval” in these comments, we refer to onerous regulatory controls that can be imposed on any filing system.

Like our predecessor organizations, PCI continues to believe that the most desirable regulation of insurance is that which achieves a competitive insurance marketplace. However, regulatory systems in some states have failed in recent years to adapt to changes in both the industry and the marketplace they oversee. Many state regulatory systems have become bloated and inefficient. The expansion of regulatory requirements combined with the lack of uniformity epitomizes regulatory inefficiency. To achieve the goal of market competition for all consumers, regulatory impediments must be eliminated. PCI believes that regulatory rules, procedures and philosophies should be directed toward stimulating market competition, not impeding it, and insurance regulatory systems should be structured to encourage the natural infusion of private capital into the industry.

Regulation of rates and forms is the most critical element of insurance regulatory reform for the property/casualty industry. Excessive governmental interference and control in the development of rates and forms are the prime drivers of the call for regulatory modernization by property/casualty insurers.

PCI supports open competition rating laws as the most desirable approach to rate regulation for the entire industry. Studies verify that consumers in states where competition is the primary regulator of price benefit from expanded choice, innovative pricing and improved insurance availability.

Therefore, PCI supports pure competition-based regulatory systems, as exemplified by the Illinois model. For example, Illinois, which has had competition-based rating since 1971, has an exceptionally healthy personal lines insurance market. Many insurers compete for business in all parts of the state – including major urban areas. In fact, there are 224 insurance companies domiciled in Illinois alone, while more than 500 carriers write auto insurance. Without a doubt, the open competition rating law has worked successfully for Illinois consumers. Given its population size and concentration, traffic density, housing values, and other factors affecting losses, Illinois would normally be expected to rank among the top ten states for insurance costs, yet it repeatedly remains in the middle range among all states for auto and homeowners prices. In addition, the auto assigned risk pool comprised of consumers who, because of poor loss histories, cannot find insurance in the standard market is extremely low: one-tenth of one percent. Consumers in every state would similarly benefit from the adoption of competitive market systems.

While Illinois has a long history with competitive markets, more recently South Carolina has shown that competitive market reforms produce significant benefits for consumers. In 1999, the state abandoned its prior approval system. Since this change, 105 auto insurers have entered the market, average auto insurance rates have decreased and the state's residual market plan has declined to fewer than 600 drivers, compared to the more than 750,000 drivers it serviced less than a decade ago. The end result is that the system is more fair and responsive and meets the need of consumers, regulators and insurers.

These examples stand in stark contrast to the experience of consumers in other states, such as Massachusetts. The subcommittee has heard extensive testimony on the regulatory failures of the Massachusetts system and the consequences to consumers. This state has a poorly working regulatory system which includes excessive regulation of rates, forms and underwriting that has discouraged new companies from entering the market and led to a decrease in choices available to consumers. By law, the insurance commissioner in Massachusetts mandates rates that must be utilized by all insurers, with only limited deviations permitted. In addition, state statutes prescribe the precise form of coverage that must be made available to all consumers. This over-regulation in the state has driven insurers out of the market and caused unprecedented growth in the residual market. Moreover, the regulation of the residual market itself has worked to deny consumers choice by driving away carriers.

As evidence of Massachusetts' regulatory failure we need only look to the number of insurers domiciled or operating in the state. The number of domiciled companies is one of the lowest in the country. Moreover, the number of licensed auto insurers is 45 percent lower than the average number of auto carriers doing business in the states throughout the nation. Given the state's number of drivers, this quantity is remarkably low and very disconcerting. As a result, the Massachusetts Commonwealth Automobile Reinsurers (CAR) system, which distributes high-risk policyholders among participating companies, remains a concern in this state. CAR and the accompanying state-established rate process have produced a non-competitive market with a disproportionately low number of auto insurers doing business in the state and an unhealthy concentration of business among only a handful of writers.

Opponents of competition-based rating have the misguided impression that a prior approval system keeps insurance rates down. In fact, it is competition that keeps rates down. Prior approval systems require regulators to inefficiently use their time to review and approve rates that are governed by competition and have adverse consequences for consumers, when that time would be better spent in solvency review to assure that the promise is met.

PCI encourages the subcommittee to take an aggressive position with respect to rate and form regulation and to make this element the prime focus of any reform effort. To improve insurance regulation for consumers, regulatory half-measures are not as effective as comprehensive rate regulatory reform for all property/casualty lines. Attempts to enact "stepping stone" systems will not provide the tangible benefits to consumers of pure competition based models. To ensure the fullest benefits to consumers across the nation, PCI strongly urges the Chairman and members of the subcommittee to insist on inclusion of the strongest open competition provisions in any reform legislation.

Similarly, form regulation should be based on market principles. Innovation should be encouraged by any regulatory scheme. Form filings also should be competitively based, i.e., informational only. The objectives of achieving regulatory modernization on forms are the same as for rates: choice, convenience and innovation. External factors driving insurance market conditions affect insurance contracts as much as insurance pricing. Property/casualty insurers must be able to bring new products to market and adjust previously introduced contract forms to market changes and conditions in an expedient manner.

Unfortunately, the current filing and approval processes among states are often quite different and introduce unnecessary complexity, delay and cost for property/casualty insurers. Inefficiencies in the system stifle product innovation, reduce competition and increase costs to consumers. Form regulation, like rate oversight, should be predicated on the concepts of information and disclosure. The goal of form regulation should be to ensure consumer access to information and facilitate development and marketing of new products.

To ensure effective and competitive markets, it is necessary to guarantee access by all insurers to credible data, including companies that operate as single-state insurers, or regional writers transacting business in a limited number of states. Because of smaller books of business, these companies are not always able to develop actuarially credible rating information through their internal loss experience alone. They depend on the availability of aggregated prospective loss cost data in order to develop rates. Without this loss cost information, these companies would be unable to compete effectively with companies who serve these markets, limiting consumer choice. Furthermore, a start-up insurer or an insurer entering a line of business for the first time will not have any credible data of its own to utilize. Access to loss data is critical for market entry.

In addition, many property/casualty insurers (both large and small) rely on the availability of supplemental rating information developed by licensed advisory organizations such as the Insurance Services Offices (ISO) to price their products. This advisory information would not be available if all insurance companies do not report data or are constrained from reporting data as the result of antitrust law exposure. The McCarran-Ferguson Act provides a limited antitrust exemption under which statistical agents can collect data, and insurance companies can pool and use aggregated loss data.

The availability and reliability of loss cost data is essential to the effective operation of competitive insurance markets. In the absence of such data, all but a few insurers would confront increased operating expenses. Access to accurate and reliable data would become a barrier to market entry. Over time, it could threaten the small company franchise, prevent new entrants into the insurance industry and have a chilling effect on the ability of existing insurers to expand into new markets or new product lines, ultimately reducing consumer choice.

It is imperative that any reform proposal retain the antitrust exemption for loss cost data and continue to require the submission of data by all insurers.

Additional Market Reforms

In addition to the competitive market provisions of the proposal, Chairman Baker has identified a number of areas for reform including market conduct, company and producer licensing and elimination of desk drawer rules. As we have previously noted, these other areas of reform are important, but their impact on improving the insurance marketplace pales in comparison to the value of competitive market reforms. We commend Chairman Baker for proposing additional procedural reforms, but encourage the committee to focus its efforts on rate and form reforms.

We appreciate the chairman's efforts to pursue a coordinated system of standardized market conduct review based on market analysis to identify patterns of abuse and on-sight review of company systems and controls. PCI believes that market analysis must be the cornerstone of any market conduct action to allow states to target their limited resources on the most significant problems. It is also imperative that the standard for review in any market conduct action must be the laws and regulations in effect at the time of the conduct being examined. It is illogical and unproductive to attempt to examine insurers for compliance with rules and regulations that did not exist during the period of the examination. To address problems in the current market conduct examination system, it is also essential that insurers be provided with effective due process protections, including independent arbitration procedures.

With respect to licensing, PCI believes that important reforms of producer licensing laws are necessary and achievable. In response to prior congressional action, many states have moved toward reciprocity; however, failure to participate by several large-market states has reduced the efficiencies hoped for with the adoption of the federal standards. There is broad support among producers, carriers, consumers and regulators to take the next steps beyond the mandates of Gramm-Leach-Bliley and move toward a national approach to ensure full reciprocity for producer licensing across all 50 states in producer licensing. From a company licensing perspective, varying state standards can serve as a market entry impediment. It can take a company wishing to become licensed in all 50 states over a decade to complete the process. These delays reduce markets for new products, impede competition for products and limit consumer choice. As a result, PCI supports efforts to streamline market entry.

Another particular area of frustration and concern for PCI members is the existence of regulatory rules that have not been codified or formally adopted through regulatory proceedings, often referred to as “desk drawer rules.” Insurance companies are not in a position to know what the desk drawer standards are in advance of their application for a license or rate or form filing, nor are they kept abreast of revisions, should they occur. In fact, the authority for these standards is often lacking or questionable. Application of these unpublished and unpredictable procedural requirements often serve as barriers to market entry and thwart the efforts of insurers to offer new products and services for consumers. Furthermore, it is impossible for insurers to make meaningful business and operational decisions when they are in danger of violating unwritten rules. Chairman Baker proposes to eliminate these so-called “desk drawer” rules. PCI supports efforts to outlaw such inefficient and arbitrary obstacles to effective market operation, but suggests that the most efficient way to eliminate “desk drawer” rules is by implementation of competitive market principles. By definition, there can be no desk drawer rules for rates and forms in a competitive market.

Role of the NAIC and Federal Government

There is no clear consensus among the property/casualty industry on the appropriateness of a federal supervisory or management role in insurance regulation. While a significant segment of the industry supports the adoption of an optional federal charter approach to regulatory modernization, the majority of main street insurers are reluctant to cede any form of regulatory authority to the federal government or to a non-governmental institution such as the National Association of Insurance Commissioners (NAIC). However, all agree on one thing and this is that the greatest threat to efficient markets is dual or multiple layers of regulation. Creating new oversight institutions or layers of reporting will drive up the cost of insurance products, make it harder for smaller companies to compete and ultimately reduce consumer choice. As a result, attempts to unnecessarily expand the regulatory or oversight role of the NAIC or to create a new and duplicative layer of quasi-regulatory authority at the federal level are almost certain to introduce needless controversy into any reform measure.

Conclusion

PCI is pleased that Chairman Baker and the subcommittee have taken an active interest in pursuing targeted state insurance regulatory reforms. We share the goals of the committee of developing a more competitive marketplace, providing better availability of insurance and expanding coverage capacity for consumers.

While PCI supports the general reform concepts, the specific details of the final proposal will be determinative of the level of support of PCI member companies. On behalf of our over 1000 members, we look forward to working with the committee to modernize and improve the state insurance regulatory system.